the higher ratings garnered in primetime, television stations generate the majority of their revenue during nonnetwork time periods.

There is substantial competition among stations in the same market. Stations are hotly competing with each other for spot and local advertising in the market, and are continually measuring their market share against their station rivals. Advertising sold on one station in a market is a close substitute for advertising sold on another in the same market, and pricing or programming errors made by one station will redound to the benefit of another station in the market well before it affects any other entity. As a result, stations closely monitor what their rivals are doing and measure their performance on the basis of market share. Thus, it is the stations in the same market that have a horizontal relationship since they directly compete with each other for audience and advertising.

III. The Economics of Television Advertising

Advertising is an investment whose ultimate purpose is to produce incremental sales. As with other investments, the greater the return on the advertising investment the more advertisers will spend. For that reason, advertising tends to be highly sensitive to economic fluctuations since a stronger economy generates higher sales, and makes the advertising investment more productive. In the same way, an economic downturn leads to reduced advertising expenditures.

Thus, the significant variable in determining the price of advertising is advertiser demand. The supply of commercial inventory available to be sold to advertisers is, for all practical purposes, fixed. Each program contains a given number of commercial spots which are available to sell. The networks or the stations can determine how much of their available inventory they wish to sell in a way that maximizes their revenue. Moreover, the commercial inventory is highly perishable. An unsold spot today cannot be sold tomorrow. Thus, an unsold spot represents revenue lost which can never be recaptured.

The television advertising market, therefore, has the characteristics of an economic rent. The sellers of advertising time (i.e., the stations) have a vertical supply curve which they try to set at the point that maximizes revenue. Television stations have the option of selling advertising time either to local advertisers, or to regional or national advertisers, and they can readily shift inventory from one to the other. The mix between spot and local sales is determined in such a way as to maximize revenues to the station.

Thus, at any given inventory level, advertising prices are entirely demand-determined. The only way either a network or station can attempt to affect prices is to withhold inventory from the local market. It is not sufficient, however, for only one network, or one station, to reduce inventory. For such a strategy to be successful, the overall supply of inventory must be reduced. Otherwise, if the overall supply remains basically unchanged, the price will likewise remain basically unchanged as well, and advertisers will simply shift their purchases from one seller (who is withholding inventory) to another (who is not). Thus, it is not enough for a single player in a local market to reduce its supply. The remaining players in the market must conspire to similarly hold supply down, and, in effect, refuse to take advantage of the available demand in the market.

A second factor basic to an understanding of the television advertising market is that advertisers are purchasing access to audiences whose value is determined by size, demographic makeup, and other factors appealing to advertisers. For this reason, no two geographical markets are alike. Each geographical market has unique characteristics in terms of size, growth, economic viability, income distribution, demographic makeup, employment characteristics, and so on.

Consequently, unit costs and cost-per-thousand viewers (cpms) for commercial spots differ widely between geographical markets. and no one geographical market is a perfect substitute for another. Stations within the same geographical market, however, are close substitutes, much closer than stations in other markets and, most assuredly, far closer than the broadcast networks.

Since advertisers are interested in ratings points and demographics, the television networks have created an upfront "market" to allow advertisers to secure commercial inventory in advance at guaranteed rates for guaranteed ratings. Thus, in the summer preceding the broadcast season, advertisers lock in advertising time for the programs on which they wish to appear in the coming season. The majority of the commercial inventory on the networks is sold upfront. A portion of the unsold inventory is withheld to give back to advertisers should the programs not achieve their ratings guarantees. Other inventory is used for program promotion by the networks and is not sold to advertisers. The remaining inventory is sold in the scatter "market" at or near the time of airing.

By contrast, television stations sell all their time in the scatter "market". Accordingly, the impact of national spot rates upon network rates is limited and indirect.

A third critical factor in understanding the television marketplace is that not all stations are alike. For example, the low channel position and stronger signal of VHF stations typically provides them with a wider reach and a larger audience potential than UHF stations. While cable subscribers can receive UHF stations clearly, the channel position still works against such stations, and in the average market nearly 40 percent of households do not subscribe to cable.[2] The strength of the early evening news is also important. The station with the strongest early evening news program typically enjoys the highest total day ratings regardless of their network affiliation.[3] For these reasons, television networks are not indifferent as to which station they choose to affiliate with. VHF stations with strong news departments are highly desired by the networks because they will deliver a larger audience for the network schedule. For this reason, Fox invested $500 million in the New World Communication Group simply to upgrade its

[2] Paul Kagan Associates, *The Kagan Media Index*, August 1995.
[3] More than 80 percent of television stations that have the highest ratings for their early evening news programs also have the highest ratings on a total day basis, regardless of affiliation. Special Analysis. Wilkofsky Gruen Associates, 1992.

affiliations in the New World markets from UHF stations to VHF stations. Fox already had affiliations in these markets but put a value of $500 million for stronger stations, demonstrating conclusively that not all stations are alike. Thus, VHF stations have substantial bargaining power with respect to the television networks. Networks are not likely to trade a VHF affiliation for a UHF affiliation, or a station that is a news leader for a station with lower local news ratings. In virtually every television market, there are more television networks (including the new networks) than there are VHF television stations. Thus, in terms of the balance of power between the networks and their affiliated stations, the power now lies clearly with the affiliates. The sharp increase in network compensation over the past year demonstrates the shift in power in favor of the affiliates.

IV. The Conditions Required For Market Power

According to MiCRA, "elimination of the Rep Rule could lead to high prices if a) network and national spot advertising are imperfect substitutes, and b) either

> I) network advertising is a relevant product market in which Rep Rule-constrained networks have a dominant share, or
>
> II) national spot advertising is a relevant product market in which Rep Rule-constrained network affiliates have a dominant share in at least some local markets."

Condition "b" clearly does not apply. While it may be tautologically true that the networks together dominate the network market, and that affiliates together dominate the station market, it is also true that no one network dominates the network market and that there are few local television markets where one affiliate can be said to dominate a local advertising product market--even one defined to include only broadcast stations. Networks are in intense competition with each other to attract national audiences and national advertising, and no one network can impose above-market ad rates without losing advertising to its rival networks. In the same way, stations in local markets aggressively compete for audience and advertising. MiCRA makes no attempt to explain how the conditions enumerated above could possibly be met, and indeed they cannot be met.

MiCRA goes on to say that there would be "no effect on either network or national spot prices only if both the network had no ability to affect price in the network advertising market and the local station had no ability to affect the price of national spot advertising in its local market." As we will demonstrate in detail below, both conditions hold. Neither individual networks nor individual stations can set above-market prices without losing advertising to network and station competitors. The networks are constantly altering their programming and scheduling in order to gain an advantage with respect to their rivals, a pointless exercise if they could unilaterally affect advertising prices. The stations, likewise, are constantly attempting to promote their local news, and outbid their rivals for the most attractive syndicated programs, equally pointless exercises if they could unilaterally affect the price of national spot advertising in their local markets. MiCRA makes no attempt to explain how either condition fails to be met, and indeed, these conditions are met.

V. The Werden Model

Prof. Werden's model relates to mergers between firms that are not in the same market, but that nevertheless compete (e.g., firms producing glass bottle containers and firms producing metal can containers)--essentially an imperfect horizontal relationship. The network-affiliate relationship, however, not only does not involve a merger, but is fundamentally a vertical relationship--the classic relationship between a supplier and a distributor. In proposing that there is a semihorizontal element to the relationship, MiCRA is suggesting that a network competes with its own affiliates in the sale of time. But this is the very proposition that remains to be proven. (In fact, networks are not in a competitive relationship with their own affiliates, but rather in a partnership relationship. Networks rely on having strong, prosperous affiliates and have every reason to wish their own affiliates great commercial success.) By assuming, as its basis for applying the Werden model, the very matter to be proven, the MiCRA Analysis is little more than a tautology.

The MiCRA Analysis then proceeds to misapply the Werden model to the network-affiliate relationship. Prof. Werden establishes extremely rigorous conditions under which his model would apply--conditions which the network-affiliate relationship fail to meet. The MiCRA Analysis simply assumes such conditions apply without offering any proof. In fact, even where there are only a limited number of competitors Prof. Werden's conditions would not be met. In Prof. Werden's own example,

> "...we can envision three firms, each with a 25% share. Here the details of market conduct must be known before any determination can be made, but it is unlikely that any one firm really has the power to set price that would be necessary to proscribe a semihorizontal merger. Finally, it will rarely be the case that a second- or third-place firm in a market has the power to set price unless that power has been delegated to it by the others, and even in that case it is unlikely that they will permit it to alter price just because of a merger between it and a producer of a substitute product."[4]

[4] G. Werden, "Section 7 of the Clayton Act and the Analysis of 'Semihorizontal' Mergers", *The Antitrust Bulletin* 27-1, Spring 1982, p.144.

The network environment, with 4-6 firms, is even more competitive than Werden's hypothetical example. Moreover, once we examine the details of market conduct with respect to competing networks and competing stations within each geographical market, it becomes clear that such anticompetitive behavior is even more farfetched under Prof. Werden's own rigorous conditions.

Nevertheless, we will examine the Werden model as if it were applicable and demonstrate that it still makes no economic sense in the context of the network-affiliate relationship. The Werden model must clear two hurdles to be applicable: one of the two merging firms must have power to set price, and either firm must have unilateral market power. In applying these conditions to the network-affiliate relationship, the first hurdle would require that the network as a sales rep must have some control over an affiliate's price. MiCRA, however, fails to demonstrate how a network can control an affiliate's price in the spot "market".

For example, if a network were to try to impose higher spot prices in the hope of diverting spot revenue to the network "market", the following scenario would be required. The network, as sales rep to the station, would attempt to raise spot prices by directly or indirectly withholding spot inventory--directly by simply shifting some spot inventory to the local market (or eliminating it entirely), or indirectly by demanding an above-market price and thereby failing to sell the available spot inventory. The immediate result of either strategy would be to create excess (or unmet) demand in the market.

The closest substitute for a spot ad on one station in a market is a spot ad on another station in the same market. Rival stations in the market will see the price of spot inventory rising. If, at the margin, stations can command a higher price by selling their inventory in the spot market rather than in the local market, rival stations will shift inventory from local to spot to take advantage of this development.[5] The result will be a windfall in revenue for the rival stations.

The station represented by a network-owned rep will also quickly see the results of this strategy--unsold spot inventory which has no economic value, or a higher proportion of inventory sold at lower prices, on average, in the local market. In either case, this affiliate would experience a drop in revenue and a loss in market share to its rivals.[6]

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[5] In equilibrium, the marginal price of a spot ad would be equal to that of a local ad. Consequently, any increase in the spot price would lead to a shift in inventory from local to spot.

[6] If there were no drop in revenue, the station must have previously been operating at a suboptimal point, and the new arrangement was merely correcting a distortion. We will assume, as do the SRA Comments and the Analysis, that the current rep firms are doing a good job and that the stations are maximizing their revenue.

Once this affiliate realizes the consequence of this strategy, it will institute a correction. As MiCRA indicates, all pricing decisions must meet with the approval of the station. A station will not knowingly engage in price behavior that lowers revenue. Moreover, a network cannot force a station to do so. Given that networks have been forced to reduce the number of program hours which they offer to their affiliates because of clearance problems, it remains a mystery as to how they could force their affiliates to consciously misprice their inventory. An affiliate is under no obligation to use a network as its rep firm, and even if it chooses to use a network, the station certainly retains the last word on pricing. Moreover, the networks, to enforce such irrational behavior on the part of the affiliate, cannot credibly threaten to switch affiliations as MiCRA would have us believe. In addition to long-term contracts that may already be in place, the network would implicitly be threatening to choose to affiliate with a weaker station in the market, an irrational act on the part of the network that would jeopardize its national ratings and national advertising.[7]

[7] If there were already a stronger unaffiliated station in the market, the network would have already chosen to affiliate with that station.

In applying the second Werden hurdle to the network-affiliate relationship, either a network or its affiliate must have unilateral market power. MiCRA, however, fails to demonstrate unilateral market power in any market. All the evidence is to the contrary. Not only do advertisers have numerous national television outlets at their disposal (broadcast networks, national spot. barter syndication, and cable), but there are numerous national outlets in other media (including magazines, radio, and newspapers) as well. Moreover, each network is competing nationally against the other networks for audience and advertising, and the same is true locally for each station. With multiple network and multiple station competitors, no one network or station could set a price above the market price and make it stick--the requirement for an entity with unilateral market power.

MiCRA implicitly concedes this point by arguing that multiple repping mergers have the same effect as unilateral market power, but does not explain why. Even if each network reps its affiliated stations, the networks still compete nationally and stations still compete locally, and neither side has unilateral market power. If the network-owned rep of an affiliate chooses to raise prices above the optimal level, rival stations in the market, including stations repped by a network, will benefit by expanding their supply of spot inventory and taking advantage of the opportunity as previously discussed. The rival stations will also enjoy higher revenues and the rival networks will also enjoy higher rep fees. Thus, as long as each party behaves in its own economic interest, neither a network nor its affiliated station can possibly have unilateral market power.

The unspoken assumption in the MiCRA Analysis is that the networks will collude. Despite efforts in earlier decades by numerous regulatory agencies to demonstrate network market power in a non-cable universe, there historically has never been any evidence of network collusion, and neither the SRA Comments nor the Analysis demonstrate how such collusion could occur that would escape the attention of the affiliates or the regulatory agencies. Moreover, as we will demonstrate next, it is not in the interest of the networks to collude. Rival networks have far more to gain by being competitive as sales reps, and thereby profiting from the windfall created by a rival network's trying to dictate prices in the spot market.

Thus, the value of the Werden model--as measured by its own criteria--is nil. Neither the SRA Comments nor the Analysis demonstrate how either of the Werden conditions can be met, which in fact they cannot.

Part VI. The Impact on the Networks of Withholding Spot Inventory

Even if we stipulate that the affiliates will somehow permit the networks to withhold a portion of their spot inventory from the market to the affiliates' own economic disadvantage, it is still not in the interest of the networks to do so. Again, we will delineate the outcome of such a theoretical strategy.

As we have shown previously, it is in the interest of the rival stations to expand their spot inventory when a given affiliate chooses to withhold some of its own. Since there are at least four affiliated stations in most major markets, there is ample availability of inventory on the remaining stations to expand supply and absorb most, if not all, of the excess demand created by the remaining affiliate. If, say, one station were to reduce its spot inventory by 10 percent, the remaining stations would merely have to shift 3 percent of their inventory from local to spot to absorb virtually all of the excess demand. The result would be that most of the excess demand would be captured in the national spot market itself, and there would be very little excess demand that could spill over into network advertising.

Thus, the possibility of enhancing network demand by raising spot prices is at best limited. In addition, since the network has at most only residual inventory available to sell in the scatter "market", the benefits of such a spillover strategy would be further limited. Also, the fact that a portion of the spot "market" consists of regional advertisers that are not interested in network advertising means that the spillover impact is further diluted. Since advertising budgets have already been established, even national advertisers will not readily trade up to a network buy should spot prices increase.

And in the end, the strategy of withholding inventory would prove entirely futile. Even if there were a measurable increase in network demand, that increase would have to necessarily affect the entire network "market".[8] Thus, most of the benefit of that increase would go to the competing networks, further minimizing any possible benefit to the network that initiated the spillover strategy.

The assertion by MiCRA (p.5) that only if the supply of national and local advertising were perfectly elastic would there be no impact on the network demand is also incorrect. In fact, all that is required for the network marketplace to be

[8] Of course, such a spillover strategy would have little meaning if it only occurred in a handful of markets. In order to have any conceivable impact on the network market, the spot inventory would have to be reduced in virtually every market.

insulated is that the supply of the spot inventory on the rival stations increase as much as the decline in the spot inventory for the station represented by the network. In that case, the overall market supply would remain unchanged, and there would be no excess demand that could possibly, and favorably, affect network scatter prices. In addition, since networks typically have limited inventory available to sell in the scatter "market", changes in spot prices can have at most only a minimal impact on overall demand for network advertising.

At the same time, this kind of ill-conceived strategy would not be cost-free to the network. As we have shown earlier, rival stations would receive an economic windfall from this process, while the revenues of the network's own affiliate would suffer. That means that rival stations would be in a better position to bid for syndicated programs and to upgrade their news programming, while the network's own affiliate would have less revenue with which to compete. The likely result would be that the rival stations would gain strength, and deliver a larger audience to rival networks. Ratings for the network that instituted such a strategy would suffer, and advertising revenues would suffer as well. Thus, any remotely conceivable benefit that a network would receive from withholding spot inventory for its affiliate would produce a more than proportional decrease in revenues due to a weakening of its affiliate lineup. All that a network would accomplish by withholding inventory would be a reduction in its own commission revenue from its repping operation since its affiliate would sell less advertising, while achieving no positive effect on network prices. Of course, if a network adopted that same inventory withholding strategy for its owned and operated stations, it would not only sacrifice repping commission revenue, but the advertising revenue lost by its O&Os as well.

Part VII. Network Repping Cannot Enhance Clearance

The SRA Comments go beyond the MiCRA analysis and postulate additional scenarios that the networks could use to pressure their affiliates. One such scenario is that a network, in its rep function, could somehow induce affiliates to increase their clearance rate. It is not stated how such pressure could be utilized. The SRA Comments pose the question, "can anyone imagine a network-owned rep company advising the local affiliate to preempt network programming?"

Surely, an affiliate that chooses a network-owned rep will be aware of any possible bias with respect to clearance. Affiliates have dealt for years with the natural desire of the networks to obtain the greatest possible clearances for their programs.

Affiliates are also familiar with the economic consequences of clearance versus nonclearance, and are accustomed to making that calculation. The programming decisions rest with the affiliate, and any recommendation by the rep firm must be approved by the affiliate. Network preferences notwithstanding, station clearance patterns are economically determined. We would instead ask the question, "can anyone imagine an affiliate failing to select a program that would generate more net revenue?" In any event, by acting as an advisor that does not have the station's interests at heart, the networks would risk being dropped as the rep firm by their affiliate for giving bad advice.

Part VIII. The Power is in the Hands of the Affiliates

The SRA Comments argue that the recent spate of long-term contracts cuts both ways. That is, while the affiliate has the security of a long-term network commitment, it cannot readily change affiliations. This is true, but totally irrelevant to the issue at hand. The fact that an affiliate has a contract with a network in no way implies that the network can compel an affiliate to accept it as its rep firm. Moreover, if the network proves to be an unsatisfactory rep, the affiliate can readily switch reps without fear of losing its affiliation. Indeed, the rise in network compensation and the introduction of long-term affiliation contracts reflect, in part, the desire of the networks to ensure the stability of their distribution systems, especially given the growing strength of Fox, and the emergence of the new United Paramount and WB networks.

Part IX. The Expiration of Fin/Syn Has No Bearing on the Rep Issue

The SRA Comments also argue that the expiration of the financial interest/syndication rules (Fin/Syn) give leverage to the networks. If a network has a hit syndicated program, for example, it allegedly can use that program to induce an affiliate to choose it as its rep firm. With this argument, however, the SRA Comments implicitly recognize the fact that the network-affiliate relationship gives the network no power in compelling an affiliate to select it as the station's rep, and must use incentives.

Of course, the availability of syndicated programs confers no power either. The development of hit syndicated programs is unpredictable, and such programs can come from many sources, including the various studios and independent production companies, as well as the networks. No one network, or studio, has a monopoly on hit syndicated programs. Although a network could theoretically offer a syndicated program and a representation arrangement in a package deal, such an arrangement would necessarily come at a lower price than if the program were offered separately. It would manifestly not be in the networks' interest to accept below-market consideration for a popular syndicated program.

Further, the SRA Comments do not even suggest that the networks could force their affiliates to accept their own syndicated product at the expense of other programs available in syndication. No affiliate would ever agree to such an arrangement. Thus, the principle of diversity would not be compromised, and independent producers with quality programs will face no impediment in being carried by stations, including stations repped by networks.

Part X. Advertising Exclusivity Has No Bearing on the Rep Issue

The SRA Comments further assert that a network rep will want to preserve advertiser exclusivity granted by the network by failing to sell local spots to competitors. The networks indeed offer advertisers exclusivity in their product line, in return for a higher rate, for certain broadcasts. The networks, of course, have no control over the commercials aired by local stations in the adjacencies. That fact has not appeared to diminish the ability of the networks to extract a premium from advertisers for exclusivity. The SRA Comments offer no evidence, and do not imply, that lack of control of local sales affects exclusivity premiums.

The reason that advertisers appear to be indifferent to the content of ads shown in the adjacency slots is that spots shown on local stations do not appear nationally. Thus, a commercial shown locally in one market will be different from a commercial shown in another market. The national impact, therefore, is diluted, and advertisers have been willing to pay handsome premiums for exclusivity despite the fact that ads by competitors may also appear locally. Since there is no evidence that the networks have sacrificed revenues due to lack of control of local ads, there is no reason to believe they will seek to control these ads. At the same time, it is in the interest of the network rep to sell time to the highest bidder since in that way the network rep maximizes its repping revenue.

Part XI. Conclusion

Neither the MiCRA analysis, nor the SRA Comments show how the networks can set or influence the price for national spot advertising. The Werden model has no application in this context since its own criteria are not met. We have also shown that any changes in spot prices that might occur can have little, if any, impact on the demand for network advertising. Moreover, we have demonstrated that it is not in the economic interest of the networks to affect spot prices even if they could do so. The networks have far more to lose than to gain. The networks are dependent on their affiliates to provide a strong platform for their network programs. Any strategy that weakens their own affiliates while strengthening the affiliates of rival networks is sure to be counterproductive. None of the other scenarios offered in the SRA Comments or in the MiCRA Analysis stand up to scrutiny either.

Repeal of the Rep Rule would introduce new competition into the rep market, affording television stations a wider choice of repping firms. The benefits of competition--lower prices and greater innovation--would presumably follow. Thus, the public interest would be served by allowing the television networks to participate in the rep business.